Tax Briefing

ADMINISTRATION'S 2017 TAX REFORM OUTLINE

May 25, 2017

Special Report

HIGHLIGHTS

- Tax Reform Options
- FY 2018 Budget Proposal Expands on Tax Reform Outline
- Reduced And Consolidated Individual Tax Rates
- 15% Corporate Tax Rate
- 15% Pass-through Tax Rate
- Elimination Of AMT
- Repeal Of Federal Estate Tax
- Repatriation Tax Break
- Move To Territorial Tax System
- Details To Come

INSIDE

White House Calls For Big Individual And Business Tax Cuts, And More

President Trump on April 26 unveiled his tax reform outline—the "2017 Tax Reform for Economic Growth and American Jobs." The administration also released on May 23, 2017 President Trump's proposed Fiscal Year (FY) 2018 Budget—"A New Foundation For American Greatness" —which contains additional information on some of the tax reform proposals in addition to large reductions in entitlement spending and increases to expenditures on border security and defense.

The outline calls for dramatic tax cuts and simplification: lower individual tax rates under a three-bracket structure, doubling the standard deduction, and more than halving the corporate tax rate; along with changing the tax treatment of pass-throughs, expanding child and dependent incentives, and more. Both the alternative minimum tax and the federal estate tax would be eliminated.

The White House tax proposal does not include spending and tax incentives for infrastructure; nor a controversial "border tax." According to White House officials, the President's proposals set out broad principles with specifics to be hammered-out in coming weeks. *This Briefing presents a high-level overview of the President's tax reform and tax-related budget proposals.*

IMPACT. *At this time, the White House proposals are just that, proposals. No legislative language has been revealed. Congressional committees will need to weigh in. The House Ways and Means Committee and the Senate Finance Committee have been engaged in tax reform discussions both in public and behind the scenes. Regarding a timeline, Administration officials have predicted that tax reform "will not slide into 2018."*

COMMENT. *The administration's proposed FY 2018 budget is predicated on the assumption that any tax reform will be revenue neutral.*

IMPACT. *If a tax reform package moves in Congress under the reconciliation rules, which require only a Senate majority, the tax cuts would likely have to sunset after 10 years. Treasury Secretary Steven Mnuchin said that the White House would prefer permanent tax reforms but "if we have it for 10 years, that's better than nothing."*

INDIVIDUALS

Tax Rates

The President's tax proposal calls for replacing and lowering the current individual tax rates with a new, three-bracket range: 10, 25, and 35 percent. Under current law, individual income tax rates are 10, 15, 25, 28, 33, 35, and 39.6 percent.

IMPACT. *White House officials said that the Administration has not yet developed the income brackets for the new rates. The House GOP Tax Reform Blueprint has called for a rate structure of 12, 25, and 33 percent.*

Standard Deduction

The President's plan calls for doubling the standard deduction. The 2017 standard deduction amounts under current law are

$6,350 and $12,700, respectively, as adjusted for inflation.

IMPACT. *One goal of a higher standard deduction is to simplify tax filing by cutting more than half those taxpayers who would otherwise do better itemizing deductions.*

COMMENT. *During his campaign, Trump had also proposed a cap on the amount of itemized deductions that could be claimed at $100,000 for single filers and $200,000 for married couples filing jointly. Additionally, according to campaign materials, all personal exemptions would be eliminated, as would the head-of-household filing status. These and other tax benefits are proposed to be eliminated to help offset the cost of the rate cuts and a higher standard deduction, but may arise during negotiations on Capitol Hill in ironing out the "details."*

Deductions

The President's plan would eliminate all individual itemized tax deductions except for the mortgage interest deduction and the charitable contribution deduction.

IMPACT. *The loss of many itemized deductions would channel an even greater number of taxpayers to the standard deduction. Big losers may include state and local governments that depend upon the federal itemized deductions for state and local income taxes and real estate taxes as an indirect subsidy for those taxes. Losing the medical expense deduction and the miscellaneous itemized deduction will also prove difficult for some taxpayers. "Above-the-line" deductions apparently would also be eliminated, although the administration would carve out deductions for retirement savings.*

COMMENT. *The administration's proposed FY 2018 budget includes reforms to both the earned income tax credit and the child tax credit, indicating that those two credits may survive.*

> "According to White House officials, the President's proposals set out broad principles with specifics to be hammered-out in coming weeks."

Elimination Of Targeted Tax Breaks

The President's tax reform proposal also outlines, without elaboration, the elimination of "targeted tax breaks that mainly benefit the wealthiest taxpayers." During his campaign, Trump had mentioned elimination of carried interest.

COMMENT. *The President's proposal does not specifically address carried interest. However, Mnuchin said the President is committed to reforming the tax treatment of carried interest.*

Net Investment Income Tax

The net investment income (NII) tax imposes a 3.8-percent tax on certain investment income of higher income taxpayers. The President has proposed to repeal the NII tax.

IMPACT. *The President's proposal apparently keeps the current framework for capital gains and dividend taxes at the top 20-percent rate. The NII generally impacts individuals with adjusted income of above $200,000 ($250,000 for marrieds, filing jointly).*

IMPACT. *The White House plan apparently does not include repeal of other Affordable Care Act (ACA) taxes, such as the additional Medicare tax and the excise tax on high-dollar health plans , but a line item in the administation's proposed FY 2018 budget includes the cost savings of ACA repeal and replacement. At the time this Briefing was posted, the House had narrowly passed an ACA repeal and replacement bill, the American Health Care Act (AHCA), but the Senate had not yet taken up the bill and Senate leaders indicated they may be working on their own version.*

Family Incentives

The President's tax proposal calls for unspecified tax relief for families with child and dependent care expenses. Under current law, taxpayers who incur expenses to care for a qualified child or for an incapacitated dependent or spouse to work or look for work may claim a credit of 20 percent to 35 percent of employment-related expenses, depending upon income level and other factors.

The administration's proposed FY 2018 budget also includes reforms to both the earned income tax credit and child tax credit. Specifically, changes would be made requiring that only individuals with Social Security Numbers valid for work would be able to claim the credits; ensuring the credits' availability only for individuals authorized to work in the United States.

COMMENT. *Trump's campaign proposals had included the creation of a new*

TIMEFRAME

At a news conference in Washington, D.C. upon the release of the tax reform proposal, Treasury Secretary Mnuchin said that the Trump administration is "going to move as fast as we can" on tax reform. The White House intends to hold listening sessions. Mnuchin added that White House and Treasury personnel are working closely with House and Senate GOP leaders on the tax reform package but he gave no specific indication of when details or legislative language will be released. Indeed, White House and Treasury officials began holding closed meetings with House and Senate members towards the end of May. Mnuchin characterized the outline as reflecting the President's "core principles" about tax reform.

deduction for child and dependent care expenses, as well as increasing the earned income tax credit (EITC) for working parents who would otherwise not qualify for the deduction. A system of "spending rebates" and "above-the-line" deductions was proposed, as well as Dependent CARE Savings Accounts (DCSAs) with matching government contributions and an expanded credit for employer-provided child care.

The proposed FY 2018 budget also includes changes to student borrowing. This includes the elimination of both the Public Service Loan Forgiveness program and subsidized student loans.

IMPACT. *It is not clear if the proposed elimination of subsidized student loans would be limited to those available as Stafford Loans (where interest on the loan is covered by the federal government while the student is in school) or if it also applies to the above-the-line deduction for student loan interest.*

Estate Tax

The President's proposals call for elimination of the federal estate tax. The current maximum federal estate tax rate is 40 percent with an inflation-adjusted $5 million exclusion ($5.49 million in 2017).

IMPACT. *During his campaign, Trump also mentioned replacing the estate tax with a carryover basis rule under which beneficiaries must use the decedent's basis in inherited assets rather than their date-of-death values. While the tax reform proposal was silent as to the fate of the gift tax, the administration's proposed FY 2018 budget includes a positive line item for estate and gift tax receipts while also proposing the elimination of the estate tax, indicating that the gift tax may survive.*

Alternative Minimum Tax

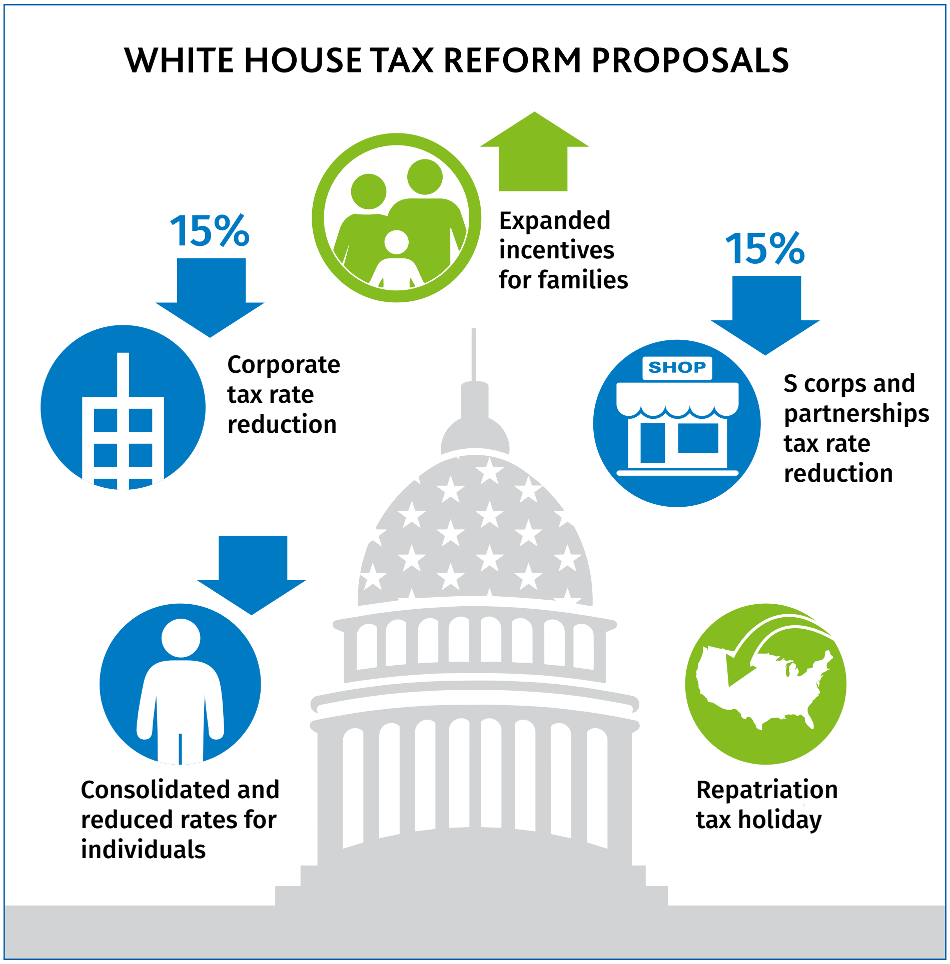
The President's proposal calls for abolishing the alternative minimum tax (AMT), calling it a complicated, unnecessary addition to the tax system. A parallel tax structure, the AMT, has existed for the stated purpose of ensuring that individuals, corporations, estates, and trusts with substantial income do not avoid tax liability. Despite exemptions, it has captured an increasing number of taxpayers to the extent that it forces many individuals "to do their taxes twice to see which is higher," according to the administration.

COMMENT. *National Taxpayer Advocate Nina Olson has recommended Congress permanently repeal the AMT. Although it serves as a revenue source, significant tax reform would likely present other options to offset the cost of elimination.*

BUSINESSES

Corporate Taxes

The President's tax proposal calls for a 15-percent corporate tax rate. The maximum corporate tax rate currently tops out at 35 percent.



IMPACT. *This proposal is being called one of the most aggressive within the President's plan, projected by some accounts to reduce revenues by $2 trillion over 10 years. Other projections call for economic growth to make up a significant part of the difference.*

COMMENT. *Although the current maximum corporate tax rate is 35 percent, many corporations now pay an effective tax rate that is considerably less. The President also proposed to eliminate unspecified tax breaks for "special interests," which would broaden the tax base and largely prevent most businesses from gaining an effective rate much lower than 15 percent.*

Small Businesses

Currently, owners of S corporations and partnerships and sole proprietors pay tax at the individual rates, with the highest rate at 39.6 percent. The President has proposed a 15-percent tax rate for pass-through income.

IMPACT. *Small business owners, therefore, would see their top tax rate on profits reduced from 39.6 percent to 15 percent under the President's plan.*

IMPACT. *This plan would appear to give a business quasi-corporate status in being able to be taxed at a new 15 percent corporate tax rate, at least until profits are distributed. Upon distribution, Trump's campaign materials had indicated that a second layer of tax would be imposed similar to dividends now taxed to C corporation shareholders.*

COMMENT. *Trump's campaign materials also had indicated consideration of rules that would prevent pass-through owners from converting their compensation income taxed at higher rates into profits taxed at the 15-percent level. Mnuchin has stated that provisions would preclude wealthy owners of large companies from gaming availability of the lower rate.*

Bonus Depreciation/Small Business Expensing

The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) extended and modified bonus depreciation and made permanent enhanced Code Sec. 179 expensing. The President's tax proposal does not specifically address bonus depreciation or small business expensing.

Business Credits

A number of business incentives were made permanent by the PATH Act, including the research credit, 100-percent gain exclusion on qualified small business stock, and the reduced recognition period for S corporation built-in gains tax. The President's taxproposal does not specifically address these and other business incentives.

Energy

Current law provides for many energy tax incentives for businesses (and individuals). The President's tax proposal does not specifically address energy tax incentives.

COMMENT. *Some popular energy tax breaks have either expired or will soon expire, setting the stage for renewed negotiations in Congress; whether to extend them, make them permanent, or allow them to sunset permanently.*

Aviation

The administration's proposed FY 2018 budget includes the transfer of many air traffic control functions of the Federal Aviation Administration to a non-profit, non-governmental entity, thereby eliminating the need for many aviation-related excise taxes.

INTERNATIONAL

Repatriation

The President's plan calls for a one-time tax on repatriated profits at a yet-unspecified tax rate. The blueprint states that "trillions of dollars" are being held overseas and potential targets for repatriation.

COMMENT. *In 2004, Congress provided that U.S. companies could elect, for one tax year, an 85-percent dividends received deduction for eligible dividends from their foreign subsidies.*

IMPACT. *The lower corporate tax rate of 15 percent may also provide incentive for businesses not to shift operations overseas going forward.*

Territorial Tax Regime

The President's plan would also transition to a territorial tax regime instead of a worldwide tax regime.

COMMENT. *"A territorial system means U.S. companies will pay tax on income related to the U.S.," Mnuchin said. "U.S. companies will not be subject to worldwide income," he added.*

COMMENT. *The administration's proposed FY 2018 budget expands upon the purpose behind a territorial tax system for businesses by stating it would allow businesses to repatriate newly earned overseas profits without additional taxation.*

INFRASTRUCTURE

In January, President Trump called for a $1 trillion infrastructure spending bill with unspecified tax incentives. The President's tax reform proposal does not address infrastructure spending.

COMMENT. *"The President remains committed to a $1 trillion infrastructure spending initiative," Mnuchin said recently. Mnuchin had appeared to indicate that infrastructure tax incentives could be part of a final tax reform package.*

IRS ADMINISTRATION

While not specifically described, the administration's proposed FY 2018 budget includes additional savings by increasing oversight of paid tax return preparers as well as providing increased authority for the IRS to address correctable errors.

COMMENT. *Presumably, both of these changes to IRS administrative authority would require changes to the Code, especially since the IRS' oversight of paid tax return preparers has been limited by judicial rulings.*

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